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IN THE

Supreme Court of the United States

October Term, 1953

No. 737

THE MARYLAND JOCKEY CLUB OF BALTIMORE CITY,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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INDEX

	PAGE
Petition	1
Jurisdiction	2
Questions Presented	2
Constitutional Provisions and Statutes Involved	3
Statement of the Case	7
Specification of Errors	11
Reasons for Granting the Writ	11
Conclusion	17
Appendix	18
Sixteenth Amendment to the Constitution of the United States	18
Internal Revenue Code, Section 22	18
Section 12 of Article 78B of the Annotated Code of Maryland (1947 Supp.)	18
Section 12 of Article 78B of the Annotated Code of Maryland (1951 Supp.)	20
Subsection (e) Section 12, Article 78B of the Annotated Code of Maryland (1953 Supp.)	23

Index of Authorities

Aransas Compress Co., 8 B.T.A. 1317	14
Commissioner of Internal Revenue v. Wilcox, 337 U.S. 404, 66 S. Ct. 546	15
Decatur Water Co. v. Commissioner (CCA 7) 88 F. (2d) 341	15
Doyle v. Mitchell Bros. Co., 247 U.S. 179, 185	14
Edwards v. Cuba Railroad Company, 268 U.S. 628, 45 S. Ct. 614, 69 L. Ed. 1124	2, 10, 11, 13, 14, 15
Eisner v. Macomber, 252 U.S. 189, 207	14
Frank Holton & Co. v. Commissioner, 339 U.S. 583, 70 S. Ct. 820	14
Estate of Lashells v. Commissioner (CCA 6), 208 F. (2d) 430	15
Stratton's Independence v. Howbert, 231 U.S. 399	14

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The petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit entered on February 3, 1954 (R. 72), based on an opinion of said court rendered on February 3, 1954 (R. 65-72), reversing the judgment and decision of the United States District Court for the District of Maryland. The opinion is officially reported at 210 F. (2d) 367 (Federal Reporter Advance Sheets, April 5, 1954). The decision of the District Court is unreported but appears at page 5 of the Record.

JURISDICTION

The opinion was promulgated on February 3, 1954 (R. 65) and judgment of the court below was entered on February 3, 1954 (R. 72). The jurisdiction of this Court is invoked under title 28, U.S.C. section 1254 (1).

QUESTIONS PRESENTED

1. Whether a fund of $75,608.66 received by petitioner during November of 1948 from The Maryland Racing Commission constituted taxable income to petitioner within the purview of the Sixteenth Amendment to the Federal Constitution or the Internal Revenue Code.

2. Whether the Circuit Court of Appeals erred in reversing the judgment of the United States District Court for the District of Maryland, in favor of the petitioner herein; by disregarding the specific provisions of Section 12 of Article 78B of the Annotated Code of the State of Maryland (1947 Supp.); and by failing to hold that under the laws of the State of Maryland the funds here involved were deducted by petitioner from the parimutual betting pools "as agent" for The Maryland Racing Commission and belonged not to petitioner but to The Maryland Racing Commission, from the very time of such deduction.

3. Whether the Court below erred by failing to hold that the fund received by petitioner from The Maryland Racing Commission was a capital grant or subsidy and nontaxable under the decision of this Court in *Edwards v. Cuba Railroad Company*, 268 U.S. 628, 45 S. Ct. 614, 69 L. Ed. 1124.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The Sixteenth Amendment to the Constitution of the United States is set forth in the Appendix, *infra*, p. 18.

Section 22(a) of the Internal Revenue Code is set forth in the Appendix, *infra*, p. 18.

Section 12 of Article 78B of the Annotated Code of Maryland (1947 Supp.) provided insofar as material, as follows:

> "12. For the calendar year 1947 and for each year thereafter, each licensee shall, as the agent of the Racing Commission, deduct one-half of one per centum of the total amount of money wagered on all races during each and every meeting and remit such deduction to the Commission. All such deductions shall be held in and comprise a fund to be known as the 'Racing Fund,' and shall be deposited by the Commission in one or more banks or trust companies in the State. The members of the Commission shall have no personal liability for loss to such Fund by reason of the failure or insolvency or other fault of any depository if they shall use ordinary care in the selection of the depository. The Commission shall require any depository to secure by collateral any deposit therein comprising a part or all of the Fund.
>
> "The amount of the Racing Fund on hand at any time, representing the deductions made by any particular licensee from the mutual pool, previously collected by such licensee, as agent of the Commission, may, with the prior written and express permission of the Commission, upon such terms and conditions as it may prescribe, be expended by that particular licensee for any substantial alterations, additions, changes, improvements, or repairs to or upon the property owned or leased by such licensee, and by it used for the conduct of racing. In determining whether to permit the use of any of the Racing

Fund, the Commission shall give due consideration to whether its expenditure in each instance will promote the safety, convenience and comfort of the racing public and of horse owners and, generally, whether it will tend towards the improvement of racing in the State. If the deductions, herein provided for, made by any licensee for any calendar year, as agent of the Commission, shall neither have been spent nor binding commitments have been entered into for their expenditure, with the approval of the Commission, within three (3) years from the last day of the year of collection, the unspent portion of such year's deduction shall revert to the State, as part of its general funds, and shall be paid over promptly by the Commission to the Comptroller. Provided, however, that due to the present war emergency, such deductions of any licensee for the calendar years 1944, 1945 and 1946 may be expended or binding commitments entered into for its expenditure at any time prior to December 31, 1950."

This statute may also be found in the Appendix, *infra*, p. 18.

Section 12 of Article 78B of the Annotated Code of Maryland was amended during the year 1951 to provide, in part, as follows:

"(a) For the calendar year 1947 and for each year thereafter, each licensee licensed under the provisions of Section 7 of this Article shall deduct one-half of one percentum from the total amount of money wagered on all races during each and every meeting and shall pay to the Maryland Racing Commission, for the use of the State of Maryland, such sums so deducted as a tax; the payment of said tax shall be accompanied by a statement of the licensee or its duly authorized agent, under oath, showing the amount of money wagered each day during the preceding meeting. All deductions and tax payments made hereunder shall be held in and comprise a fund to be known as the 'Racing Fund', and shall be deposited by the Commission in one or more banks

or trust companies in the State. The members of the Commission shall have no personal liability for loss to such Fund by reason of the failure or insolvency or other fault of any depository if they shall use ordinary care in the selection of the depository. The Commission shall require any depository to secure by collateral any deposit therein comprising a part or all of the Fund."

(Section 12, Article 78B of the Annotated Code of Maryland (1951 Supp.)

Section 12 of Article 78B of the Annotated Code of Maryland as amended during the year 1951 is set forth at page 20 of the Appendix.

On June 1, 1953 a new subsection (e) was added to Section 12 of Article 78B of the Annotated Code of Maryland, which subsection provides as follows:

"AN ACT to add a new Sub-section (e) to Section 12 of Article 78B of the Annotated Code of Maryland (1951 Edition), title 'Racing Commission', under which the power and authority of the Maryland Racing Commission to make grants to licensees from the Racing Fund is clarified.

"WHEREAS, some doubt and confusion has arisen as to the legislative intent incident to the creation and operation of the Racing Fund, as established by Chapter 961 of the Acts of 1945; and

"WHEREAS, it is the sense of the General Assembly that the real legislative intent in the passage of Chapter 961 of the Acts of 1945, as amended from time to time, was to empower and permit the Racing Commission to make, or bind itself to make, commitments or grants to licensees, within three (3) years from the last day of the year of collection, for the purposes provided in said Section 12, in such manner and upon such terms and conditions as it may prescribe; and

"WHEREAS, it is the intent and desire of the General Assembly by the enactment hereof to clearly and unmistakably express the intention which the

General Assembly believes was sought to be expressed in the passage of the original Act and Amendments thereto.

"SECTION 1. Be it enacted by the General Assembly of Maryland, That a new Sub-section (e) be and it is hereby added to Section 12 of Article 78B of the Annotated Code of Maryland (1951 Edition), title 'Racing Commission', said new sub-section to follow immediately after Sub-section (d) of Section 12 of said Article, and to read as follows:

"(e) The Maryland Racing Commission is specifically empowered and authorized, in making commitments or grants, pursuant to and for the purposes set forth in Sub-section (c) of Section 12, to make, or to bind itself to make, such grant or grants as contributions to capital, in such manner and upon such terms and conditions as it may prescribe, and any such grant or grants or commitments heretofore made by the Racing Commission are hereby ratified, sanctioned and approved, and whenever a licensee has expended or is to expend with the prior written and express permission of the Commission, for any such substantial alterations, additions, changes, improvements or major repairs, an amount greater than then credited to it in the Racing Fund, the Racing Commission is further specifically empowered and authorized to repay or to enter into an agreement to repay, the licensee for any or all of such expenditures from future payments into the Racing Fund by the licensee. This Sub-section (e) shall not be construed as implying that in the absence thereof, the provisions of this Section 12 could properly have been or shall be otherwise construed.

"SECTION 2. And be it further enacted, That this Act shall take effect June 1, 1953.

The above quoted Act may be found at page 23 of Appendix.

STATEMENT OF THE CASE

The facts are not in dispute and briefly stated are as follows:

Petitioner is now and has been for many years a corporation organized and existing under the laws of the State of Maryland, having its principal place of business at Pimlico Race Course, Baltimore, Maryland. During the periods of its corporate existence and during the years material to this suit it owned and operated a race track in the City of Baltimore, State of Maryland, at which horse racing was conducted and at which pari-mutual betting was carried on pursuant to the applicable laws of the State of Maryland. During the years of its corporate existence and particularly during the fiscal year ended November 30, 1948, its principal income was derived from admission fees and its 5½ per centum statutory share of the pari-mutual betting pools allowed by law in the operation of said race track as aforesaid. (R. 16). During the years here involved petitioner kept its books and filed its Federal income tax returns on the cash receipts and disbursements basis, using a fiscal year accounting period ending November 30th (R. 17).

The Maryland Racing Commission is a State Commission, created and established under the laws of the State of Maryland for the governing and supervision of horse racing in the State of Maryland. Its "jurisdiction, supervision, powers, and duties * * * extend * * * to any and all person or persons, associations or corporations" which hold or conduct meetings within the State of Maryland "whereat horse racing shall be permitted for any stake, purse or reward." Article 78B, Section 1, Flack, Annotated Code of Maryland, (1947 Cum. Supp.). (R. 2)

The District Court found the following facts with respect to the action taken by the petitioner (plaintiff in the District Court) during the year 1948 and pursuant to Section 12 of Article 78B of the Annotated Code of Maryland (1947 Supp.) (R. 9-10).

* * * *

"As a result of damage caused by heavy rains to the racing strip at the Pimlico Course, plaintiff determined that it would be necessary to make capital expenditures to rebuild the strip. On July 28, 1948, plaintiff so notified the Maryland Racing Commission, and on August 31, 1948, the President and Secretary of the plaintiff appeared before the Commission, and the latter's minutes show that the request of the plaintiff to rebuild the strip at an estimated cost of $70,000.00 was approved, 'payment to be made from the Racing Fund after the work has been completed and bills have been presented to the Commission and approved.' The work was completed before the end of the plaintiff's fiscal year (November 30, 1948), and before that time plaintiff received from the Maryland Racing Commission a check for $75,608.66 as reimbursement for its expenditures for the work, pursuant to bills, invoices and receipts showing plaintiff's payment of same, all of which had been submitted to the Commission. This reimbursement to plaintiff was made by the Commission out of funds which had been deducted from money wagered at Pimlico and remitted by the plaintiff to the Commission, and which the Commission deposited in the Racing Fund as required by law, as hereinbefore set forth.

"This was the first payment that had ever been made to plaintiff as reimbursement out of any funds that it had deducted from money wagered at Pimlico and had deposited in the Racing Fund. The expenses of rebuilding the racing strip were capitalized on

plaintiff's books in the fiscal year ending November 30, 1948; they were added to plaintiff's base for depreciation on its capital assets, and plaintiff claimed, and was allowed depreciation for federal and state income tax purposes on its fixed assets in the fiscal year ended November 30, 1949, and in subsequent years on the increased basis of its assets, determined by including this sum of $75,608.66. Plaintiff realized net taxable income in all of the fiscal years ended November 30, 1949, 1950, 1951 and 1952."

* * * *

On January 18, 1952, petitioner filed a claim for refund with the United States Collector of Internal Revenue, Baltimore, Maryland, for the fiscal year ended November 30, 1948 in the amount of $28,731.29, plus interest as required by law, contending that it had erroneously included in its gross income in its Federal income tax return for said fiscal year the amount of $75,608.66, received from The Maryland Racing Commission on November 29, 1948 (R. 17-18).

On April 14, 1952, the Commissioner of Internal Revenue notified petitioner by registered mail of the disallowance of said claim for refund (R. 18).

Thereafter petitioner brought an action against the United States of America, respondent herein, in the United States District Court for the District of Maryland at Baltimore, Maryland for the recovery of the aforesaid sum of $28,731.29, plus interest as required by law, contending that it had overpaid its Federal income taxes for the fiscal year ended November 30, 1948 (R. 5).

The District Court held that under the law of the State of Maryland (specifically Section 12 of Article 78B of the Annotated Code of Maryland, 1947 Supp.), the petitioner never acquired title to the funds here collected as agent

for the Maryland Racing Commission and paid over to the Commission, stating in part (R. 12):

> "* * * However, the taxpayer never acquired title to these funds, nor could it ever use them in any way until the Commission turned them over to it to be used exclusively as the Commission designated. By the very wording of the Maryland statute which provides what shall be done with them, it is required that the taxpayer 'shall, as the agent of the Racing Commission deduct' them 'and remit such deduction to the Commission.' This is precisely what was done in the present case. * * *"

The District Court then further held that the disbursement by The Maryland Racing Commission to petitioner during November of 1948 constituted a nontaxable grant or subsidy to the petitioner under the decision of this Court in *Edwards v. Cuba Railroad Co.* 268, U.S. 628, 45 S. Ct. Ct. 614, 69 L. Ed. 1124, and that petitioner was entitled to recover from the United States the sum of $28,731.29 as a refund of Federal income taxes overpaid for the fisal ycear ended November 30, 1948.

Following the decision of the District Court, the United States appealed to the United States Court of Appeals for the Fourth Circuit which reversed the District Court (R. 72) and remanded the case with directions to enter judgment in favor of the United States. The Court of Appeals held that neither The Maryland Racing Commission nor the State of Maryland ever acquired absolute title to the sums collected by petitioner for and as agent of The Maryland Racing Commission under Section 12, Article 78B of the Annotated Code of Maryland, 1947 Supp. (R. 69). The Court further held that these sums represented the taxpayers own receipts from its own operations and that accordingly the fund received by petitioner from The Maryland Racing Commission during November, 1948 was not a capital grant or subsidy to the

petitioner, nontaxable under the Sixteenth Amendment and the revenue laws (R. 69).

SPECIFICATION OF ERRORS

The Honorable Circuit Court of Appeals erred:

1. By disregarding the specific provisions of Section 12 of Article 78B of the Annotated Code of the State of Maryland (1947 Supp.) and in failing to hold that under Maryland law The Racing Commission of the State acquired title to the monies collected by the petitioner for and as the agent of said Commission.

The Court below erred by failing to hold that the disbursement to petitioner of the fund of $75,608.66 during November of 1948 constituted a nontaxable grant or subsidy to petitioner under the decision of this Court in *Edwards v. Cuba Railroad Co.*, supra.

REASONS FOR GRANTING THE WRIT

The decision of the Court of Appeals totally disregards the law of the State of Maryland found in Section 12 of Article 78B of the Annotated Code of Maryland (1947 Supp.) which provides that "* * * each licensee shall, *as agent of the Racing Commission,* deduct one-half of one per centum of the total amount of money wagered on all races during each and every meeting and remit such deduction to the Commission. * * *" (Appendix, p. 18), (emphasis added.)

Neither the 1951 or the 1953 amendments to the Maryland statute were called to the attention of the court below. The 1951 amendment provided that the amount of the funds deducted by race track operators and paid over to the Maryland Racing Commission was "for the use of the State of Maryland". (App. p. 20). The

1953 amendment clarified the intent of the Maryland Legislature and clearly pointed out that the grants by the Maryland Racing Commission to licensees were intended to be "contributions to capital" (p. 6 of this petition and p. 23 of Appendix.)

Under the Maryland statute and the interpretations thereof by the Attorneys General of Maryland (R. 47 and R. 48) the petitioner was but the agent of The Maryland Racing Commission in collecting for the Commission the one-half of one per centum of the amount of monies wagered. This fund belonged to The Maryland Racing Commission, an instrumentality of the State. Petitioner had no title or claim to this fund. The Maryland Racing Commission had clear legal title thereto. (R. 47 and R. 52)

The Maryland statute further provided that if the fund was neither spent by any licensee with the express approval and under conditions prescribed by the Commission nor binding commitments entered into with the approval of the Commission within three years from the last day of collection, then the unspent portion of the fund "* * * shall revert to the State, as part of its general funds * * *. (Section 12, Article 78B of the Annotated Code of Maryland, 1947 Supp. (App. 18).

The Attorney General of the State of Maryland, deciding that the fund was not subject to Maryland State taxes held (R. 47):

* * * *

> "It is clear that the ½ of 1% as to which you write has never been and is not the property of the Maryland Jockey Club since that body collected it as agent for the Commission and not in its own right or with any claim of title. * * *"

Accordingly the Court below erred by failing to properly interpret the laws of the State of Maryland and in

deciding that the fund collected by petitioner as agent for The Maryland Racing Commission was neither the fund of The Maryland Racing Commission nor the State of Maryland available for subsidies or grants.

There is therefore involved in this case the question of the proper interpretation of a State law with respect to its application to Federal taxation and a conflict between the interpretation placed upon a state law by the State's own officials and its Legislature and the interpretation thereof by the United States Court of Appeals. We respectfully submit that these important legal questions should be decided by this Court.

The decision of the Court below is not in accordance with law under the decision of this Court in *Edwards v. Cuba Railroad Company*, supra, and is contrary to the principles enunciated by this Court in that case. In the *Cuba Railroad* case this Court pointed out that the payments received by the Railroad Company from the Cuban Government were to reimburse the Railroad Company for capital expenditures and stated as follows:

> "* * * Neither the laws nor the contracts indicate that the money subsidies were to be used for the payment of dividends, interest or anything else properly chargeable to or payable out of earnings or income. . . . *They were not profits or gains from the use or operation of the railroad, and do not constitute income within the meaning of the Sixteenth Amendment.* * * *" (Emphasis supplied.)

In *Edwards v. Cuba Railroad Company*, supra, the Cuban Government's objective was to induce the construction of a railroad for the public interest. In the case at bar the purpose of The Maryland Legislature was the promotion of the safety, convenience and comfort of the racing public, of horse owners, and generally the improvement of racing in the State of Maryland by means

of funds "for any substantial alterations, additions, changes, improvements or repairs" of property owned or leased for the conduct of racing (Section 12, Article 78B of the Annotated Code of Maryland, 1947 Supp., Appendix p. 18).

The essential point is that the purposes sought to be obtained both by the Cuban Government in the *Cuban Railroad* case and by The Maryland Legislature in the case at bar were for the public interest.

Here, as in the *Cuban Railroad* case the funds granted by The Maryland Racing Commission to petitioner were not to be used for the payment of dividends, interest, or "anything else properly chargeable to or payable out of earnings or income". The funds paid over to the petitioner were not for services rendered or to be rendered. The funds belonged to The Maryland Racing Commission and, as intended by the Maryland Legislature (App. p. 23), represented a true capital grant or subsidy to petitioner. The payment did not constitute income to petitioner within the meaning of the Sixteenth Amendment, *Edwards v. Cuba Railroad Co.*, supra. The funds disbursed to petitioner represented neither a gain to the petitioner derived from capital or labor, or both combined, nor profit derived through a sale or conversion of capital assets; *Edwards v. Cuban Railroad Co.* See *Eisner v. Macomber*, 252 U.S. 189, 207; *Stratton's Independence v. Howbert*, 231 U.S. 399; *Doyle v. Mitchell Bros. Co.*, 247 U.S. 179, 185.

Capital grants or construction subsidies do not constitute income within the meaning of the Sixteenth Amendment or the Federal revenue laws. *Edwards v. Cuba Railroad Co.*, supra; *Aransas Compress Co.*, 8 B.T.A. 1317; *Frank Holton & Co. v. Commissioner*, 339 U.S. 583, 70 S. Ct. 820 (1950).

Furthermore we think the decision of the court below is in conflict with the decision of the United States Court of Appeals for the Seventh Circuit in *Decatur Water Co. v. Commissioner*, 88 F. (2d) 341. Finding that the taxpayer was obligated by its charter and by the contract which it held with the city to apply a certain portion of the funds received by it from the city to the retirement of its preferred stock, the Court held that such funds were not income within the meaning of the Federal revenue laws. This conclusion was reached upon a finding that the funds received by the taxpayer from the city were earmarked for a single purpose, i.e., the return of capital to the preferred stockholders. In reaching this result the Court drew upon *Edwards v. Cuba Railroad Company*, supra, for analogy and said at page 347:

> "• • • The Supreme Court in that case disregarded the form of the transaction and said that the subsidy payments, being proportionate to mileage completed, indicated a purpose to reimburse the plaintiff for capital expenditures, and not for services rendered or to be rendered. It held that they were not profits or gains for the use or operation of the railroad and not income for taxation purposes. Respondent attempts to distinguuish this case upon the facts and denies any analogy to the instant case. A careful examination of the facts of that case, however, convinces us that the analogy is pronounced and the decision persuasive."

The funds here involved were neither collected in the first instance by petitioner nor granted to petitioner by the Racing Commission under claim of right and therefore do not constitute taxable income. *Commissioner of Internal Revenue v. Wilcox*, 337 U.S. 404, 66 S.Ct. 546; *Estate of Lashells v. Commissioner* (C.C.A. 6) 208 F. (2d) 430.

The case at bar involves a substantial Federal question and one of great importance to all states. This is recognized by the United States of America, respondent herein. In fact, the United States in its reply brief, pages 11-12, filed in this case with the United States Court of Appeals emphasized and urged upon the Court the importance of the Federal question of law involved, stating as follows (pp. 11-12):

> "Although the question for this Court is whether the sum of $75,608.66 constitutes income subject to Federal tax, it is apparent that the decision in this case may determine the taxable character of all sums paid by the mile tracks into the Racing Fund since its establishment in April, 1944 and subsequently released by the Maryland Racing Commission to the tracks for approved expenditures. The public records of the Maryland Racing Commission show that $4,351,427.25 has been deposited in the Racing Fund by the mile tracks from April, 1944, to December 5, 1953.
>
> *"The underlying issue here is of even greater importance, however, to the Government than taxability vel non of the large sums which have been or may be hereafter paid over to the tracks from the Racing Fund.* If the decision of the District Court in favor of this taxpayer is sustained, it may mean that a State or a regulatory agency of a State may temporarily trustee the receipts of any regulated business e.g., a public utility, thereafter pay over or refund the amount of such receipts to the taxpayer with restrictions upon use, and so purport to establish a tax-immune state grant or 'capital subsidy.' (Emphasis supplied.)

The question is just as important and substantial as far as all the States are concerned as it is to the Federal Government. We submit that the interpretation of the Maryland statute by the Court of Appeals vitiates the very purpose of the statute itself and places in jeopardy, with respect to Federal taxation, the laws of the several

states with respect to "a State or a regulatory agency of a State" governing not only the owners and lessees of race tracks therein but also all regulated businesses and public utilities, as emphasized by the respondent in its reply brief filed in the Court below.

CONCLUSION

Petitioner respectfully submits that this Honorable Court should grant the petition for a writ of certiorari to set at rest the important Federal questions and issues of law involved herein.

Respectfully submitted,

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SIXTEENTH AMENDMENT TO THE CONSTITUTION OF THE UNITED STATES.

The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration.

INTERNAL REVENUE CODE.
SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages or compensation for personal service (including personal service as an officer or an employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * * (26 U.S.C. 1946 ed., Sec. 22.)

SECTION 12 OF ARTICLE 78B OF THE ANNOTATED CODE OF MARYLAND (1947 SUPP.)

12. For the calendar year 1947 and for each thereafter, each licensee shall, as the agent of the Racing Commission, deduct one-half of one per centum of the total amount of money wagered on all races during each and every meeting and remit such deduction to the Commission. All such deductions shall be held in and comprise a fund to be known as the "Racing Fund", and shall be deposited by the Commission in one or more banks or trust companies in the State. The members

of the Commission shall have no personal liability for loss to such Fund by reason of the failure or insolvency or other fault of any depository if they shall use ordinary care in the selection of the depository. The Commission shall require any depository to secure by collateral any deposit therein comprising a part or all of the Fund.

The amount of the Racing Fund on hand at any time, representing the deductions made by any particular licensee from the mutual pool, previously collected by such licensee, as agent of the Commission, may, with the prior written and express permission of the commission, upon such terms and conditions as it may prescribe, be expended by that particular licensee for any substantial alterations, additions, changes, improvements, or repairs to or upon the property owned or leased by such licensee, and by it used for the conduct of racing. In determining whether to permit the use of any of the Racing Fund, the Commission shall give due consideration to whether its expenditure in each instance will promote the safety, convenience and comfort of the racing public and of horse owners and, generally, whether it will tend towards the improvement of racing in the State. If the deductions herein provided for, made by any licensee for any calendar year, as agent of the Commission, shall neither have been spent nor binding commitments have been entered into for their expenditure, with the approval of the Commission, within three (3) years from the last day of the year of collection, the unspent portion of such year's deduction shall revert to the State as part of its general funds, and shall be paid over promptly by the Commission to the Comptroller. Provided, however, that due to the present war emergency, such deductions of any licensee for the calendar years 1944, 1945 and 1946 may be expended or binding commitments entered into for its expenditure at any time prior to December 31, 1950.

• • • •

SECTION 12 OF ARTICLE 78B OF THE ANNOTATED CODE OF MARYLAND (1951 SUPP.):

12. (a) For the calendar year 1947 and for each year thereafter, each licensee licensed under the provisions of Section 7 of this Article shall deduct one-half of one per-centum from the total amount of money wagered on all races during each and every meeting and shall pay to the Maryland Racing Commission, for the use of the State of Maryland, such sums so deducted as a tax; the payment of said tax shall be accompanied by a statement of the licensee or its duly authorized agent, under oath, showing the amount of money wagered each day during the preceding meeting. All deductions and tax payments made hereunder shall be held in and comprise a fund to be known as the "Racing Fund", and shall be deposited by the Commission in one or more banks or trust companies in the State. The members of the Commission shall have no personal liability for loss to such Fund by reason of the failure or insolvency or other fault of any depository if they shall use ordinary care in the selection of the depository. The Commission shall require any depository to secure by collateral any deposit therein comprising a part or all of the Fund.

(b) The Commission shall not be required to remit any part of the Racing Fund on hand at any time to the Comptroller or to the Treasurer of the State, unless and until said Fund shall revert to the General Treasury of the State in the manner hereinafter provided.

(c) The amount of the Racing Fund on hand at any time, representing the deductions made by any particular licensee from the mutuel pool, previously deducted by such licensee and paid to the State as a tax, may, with the prior written and express permission of the Commission, upon such terms and conditions as it may prescribe,

be granted by the Commission to that particular licensee as a contribution to its capital for any substantial alterations, additions, changes, improvements or major repairs to or upon the property owned or leased by such licensee and by it used for the conduct of racing. In determining whether to make such grant or grants as contributions to capital of any portion of the Racing Fund, the Commission shall give due consideration to whether its expenditure in each instance will promote the safety, convenience and comfort of the racing public and horse owners and generally whether it will tend toward the improvement of racing in this State. In the fiscal year 1952, any amount granted by the Commission, as provided in this Section, is hereby appropriated by the State, out of such tax collected in the fiscal year 1952 and out of the Racing Fund on hand on July 1, 1951, to the licensee involved for the purposes allowed by the Commission as herein authorized. For the fiscal year 1953 and for every fiscal year thereafter, the Governor shall include in his Budget or any Supplemental Budget the estimated receipts to be derived from the imposition of such tax during such fiscal year and any unexpended balance on hand in the Racing Fund at the beginning of such fiscal year, less any reversion of the same as hereinafter provided, to be granted by the Commission to such licensees as provided in this section. If amounts equal to the deductions herein provided made by any licensee for any calendar year shall neither have been spent or binding commitments have been entered into for their expenditure as grants to licensees within three (3) years from the last day of the year of collection, the unspent portion of such years' deduction and tax payment shall revert to the General Treasury of the State and shall be paid over by the Commission to the Comptroller; provided, however, that, due to the present emergency, amounts equal to the deductions of any licensee on hand in the Racing Fund at the effec-

tive date of this Act may be granted as contribution to capital by the Commission to the licensee who contributed such amount for the purposes herein provided at any time prior to March 31, 1953. If and when any licensee abandons its present location for racing and operates at the track of another licensee, its pro rata share of the Racing Fund may, by mutual agreement between the licensees involved, with the approval of the Racing Commission, be granted by the Commission and, if so, is hereby appropriated for capital improvements, as hereinabove authorized, at the track of the licensee wherein the meeting was run.

(d) Notwithstanding anything contained in this section to the contrary, the deductions made by the Maryland Jockey Club at the joint meetings held at Pimlico during the year 1944, for which it held a license, and the deductions made by the Maryland State Fair at the joint meeting in 1944, for which it held a license, shall be considered and treated for the purposes of this section, as having been made, as agents of the Commission, one-fourth by the Maryland Jockey Club, one-fourth by the Maryland State Fair, one-fourth by the Southern Maryland Agricultural Association, and one-fourth by the Hartford Agricultural and Breeders Association; and the Commission may make grants from the Racing Fund, as constituted on May 4th, 1945, to each of said four Racing Organizations, equally, in the manner and to the extent hereinabove set forth, and, for the purposes of this section, each shall be considered as having deducted from the mutuel pool one-fourth of said Racing Fund as so constituted as agents aforesaid. If, however, the Commission shall issue a license for the conduct of racing to one of the said four Racing Organizations, for the purpose of enabling a joint meeting to be held in which one or more of the others of the above-mentioned Racing Organizations participate, the deductions made by the li-

censee of said meeting shall be considered and treated as having been made, for the purposes of this section, by each of said Racing Organizations participating in said meeting, as agents aforesaid, in the proportion in which are shared the profits and losses of that particular meeting, and the Racing Commission may make grants from the Racing Fund to the Racing Organization considered and treated herein as having made such deduction, in the manner and to the extent hereinabove set forth.

SUBSECTION (e) SECTION 12, ARTICLE 78B OF THE ANNOTATED CODE OF MARYLAND (1953 SUPP.)

AN ACT to add a new Sub-section (e) to Section 12 of Article 78B of the Annotated Code of Maryland (1951 Edition), title "Racing Commission", under which the power and authority of the Maryland Racing Commission to make grants to licensees from the Racing Fund is clarified.

WHEREAS, some doubt and confusion has arisen as to the legislative intent incident to the creation and operation of the Racing Fund, as established by Chapter 961 of the Acts of 1945; and

WHEREAS, it is the sense of the General Assembly that the real legislative intent in the passage of Chapter 961 of the Acts of 1945, as amended from time to time, was to empower and permit the Racing Commission to make, or bind itself to make, commitments or grants to licensees, within three (3) years from the last day of the year of collection, for the purposes provided in said Section 12, in such manner and upon such terms and conditions as it may prescribe; and

WHEREAS, it is the intent and desire of the General Assembly by the enactment hereof to clearly and unmistakably express the intention which the General Assembly

believes was sought to be expressed in the passage of the original Act and Amendments thereto.

SECTION 1. Be it enacted by the General Assembly of Maryland, That a new Sub-section (e) be and it is hereby added to Section 12 of Article 78B of the Annotated Code of Maryland (1951 Edition), title "Racing Commission", said new sub-section to follow immediately after Sub-section (d) of Section 12 of said Article, and to read as follows:

(e) The Maryland Racing Commission is specifically empowered and authorized, in making commitments or grants, pursuant to and for the purposes set forth in Sub-section (c) of Section 12, to make, or to bind itself to make, such grant or grants as contributions to capital, in such manner and upon such terms and conditions as it may prescribe, and any such grant or grants or commitments heretofore made by the Racing Commission are hereby ratified, sanctioned and approved, and whenever a licensee has expended or is to expend with the prior written and express permission of the Commission, for any such substantial alterations, additions, changes, improvements or major repairs, an amount greater than then credited to it in the Racing Fund, the Racing Commission is further specifically empowered and authorized to repay or to enter into an agreement to repay, the licensee for any or all of such expenditures from future payments into the Racing Fund by the licensee. This Sub-section (e) shall not be construed as implying that in the absence hereof, the provisions of this Section 12 could properly have been or shall be otherwise construed.

SECTION 2. And be it further enacted, That this Act shall take effect June 1, 1953.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	2
Argument	6
Conclusion	11
Appendix	12

CITATIONS

Cases:

Baboquivari Cattle Co. v. *Commissioner*, 135 F. 2d 114	9
Decatur Water Supply Co. v. *Commissioner*, 88 F. 2d 341	9
Edwards v. *Cuba Railroad Co.*, 268 U. S. 628	8-9
Eisner v. *Macomber*, 252 U. S. 189	7
Electric Storage Battery Co. v. *Rothensies*, 152 F. 2d 521, affirmed on this point but reversed on other grounds, 329 U. S. 296	8
Helvering v. *Claiborne-Annapolis Ferry Co.*, 93 F. 2d 875	9
Lykes Bros. S. S. Co. v. *Commissioner*, 126 F. 2d 725	9
Mutual Tel. Co. v. *United States*, 204 F. 2d 160	7
North American Oil v. *Burnet*, 286 U. S. 417	7
Union Trust Co. v. *Commissioner*, 111 F. 2d 60, certiorari denied, 311 U. S. 658	8
United States v. *Lewis*, 340 U. S. 590	7

Statutes:

Internal Revenue Code, Sec. 22 (26 U. S. C. 22)	6, 8, 12
Flack, Annotated Code of Maryland (1947 Cum. Supp.), Art. 78B	3, 7, 12
Sec. 1	12
Sec. 11	13
Sec. 12	7, 13
Flack, Annotated Code of Maryland (1951 Supp.), Art. 78B, Sec. 12	7, 8
Flack, Annotated Code of Maryland (1953 Supp.), Art. 78B, Sec. 12	8
Maryland Laws of 1947, c. 502	4

In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 737

THE MARYLAND JOCKEY CLUB OF BALTIMORE CITY,
PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 5-16) is reported in 118 F. Supp. 349. The opinion of the Court of Appeals (R. 65-72) is reported in 210 F. 2d 367.

JURISDICTION

The judgment of the Court of Appeals was entered on February 3, 1954. (R. 72.) The petition for certiorari was filed on April 29, 1954. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTION PRESENTED

Whether certain sums deducted pursuant to state law by the taxpayer, a race track operator, from amounts taken in by it at its pari-mutuel windows, which sums were paid by it into a special account known as the "Racing Fund" and then released by the State Racing Commission to the taxpayer in a later year as reimbursement for expenditures involved in rebuilding its racing strip, constituted taxable income to the taxpayer in the year of release within the meaning of Section 22(a) of the Internal Revenue Code.

STATUTES INVOLVED

The pertinent statutes are set forth in an Appendix, *infra*, pp. 12-15.

STATEMENT

The facts, all of which were either stipulated or were established by undisputed documentary evidence, may be summarized as follows:

The taxpayer is a Maryland corporation which operated a race track at Pimlico Race Course, Baltimore, Maryland, where horse racing was conducted and pari-mutuel betting carried on under the laws of Maryland. During the years involved the taxpayer's principal income was derived from admission fees and its share of pari-mutuel bets allowed by law in the operation of its race track. (R. 16.) The taxpayer kept its books and filed its income tax returns on the cash basis and on the basis of fiscal years ended November 30th. (R. 17.)

In July, 1938, the State Racing Commission authorized race tracks in Maryland to take an addi-

tional 1% of the mutuel pool to be used for improving race tracks, making needed plant improvements and the promotion of livestock breeding. (Stip. Ex. H, R. 24-25.)

From 1938 to 1944, no accounting was required of the tracks by the Racing Commission with respect to the spending of the extra 1% above-mentioned, although the Racing Commission sometimes gave general approval to the same. (Plft. Ex. B, R. 48, 49.)

In April 1944, the Racing Commission adopted a series of resolutions the final result of which was to divide the additional 1% equally between a fund for purses and the "Racing Fund", it being provided that ½ of 1% representing the "Racing Fund" was to be held in the fund until the 1945 Regular Session of the General Assembly of the State of Maryland and pending its action authorizing the disposition of the fund under the supervision of the Maryland Racing Commission. (Stip. Ex. L, R. 44-45.)

In the Regular Session of the General Assembly of the State of Maryland for the year 1945, the State Legislature provided for the disposition of the fund (Flack, Annotated Code of Maryland (1947 Cum. Supp.), Article 78B); that for the calendar year 1947 and each year thereafter, each track as agent for the Commission should deduct ½ of 1% of amounts wagered and remit the amounts deducted to the Commission, this sum to comprise a fund known as the "Racing Fund" which should be deposited by the Commission in one or more

banks in the State. The amount of the "Racing Fund" on hand at any time representing deductions made by any particular track might with the prior written and express permission of the Commission and on such terms and conditions as the Commission might prescribe, be expended by that particular track for "any substantial alterations, additions, changes, improvements, or repairs" to or upon the property owned or leased by the track and by it used in the conduct of racing. (R. 50.) If the deductions provided for and made by the track were neither spent nor binding commitments for their expenditure made with the approval of the Commission within three years from the last day of the year of collection, the unspent portion would revert to the State as part of its general funds and would be paid over promptly by the Commission to the Comptroller.[1] (R. 50-51.)

For the fiscal years ended November 30, 1944, to November 30, 1948, the taxpayer deducted as agent for the Maryland Racing Commission from money wagered at its track the total sum of $624,584.27, and remitted such deductions to the Commission which deposited the money to its order in a bank selected by it in accordance with the resolutions of the Commission and the statutory law of the State of Maryland. (R. 18.) In its income tax returns

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[1] An escape clause was provided extending the time for expenditures of amounts collected in 1944 and 1945 up to December 31, 1949, when war conditions prevented expenditures sooner, and the time was further extended by Chapter 502, Laws of 1947, as to collections for 1944, 1945 and 1946, up to December 31, 1950.

the amounts paid to the Commission were deducted from its receipts (R. 18-19).

After the fall meeting of 1947 and the spring meeting of 1948 held by the taxpayer at its race track, due to heavy rains, it was necessary for taxpayer to make expenditures in rebuilding its racing strip. At the end of the spring meeting in 1948, the officers of the taxpayer decided to rebuild its racing strip as a substantial addition and improvement upon its racing property. (R. 21.)

On July 28, 1948, the taxpayer notified the Racing Commission that it proposed to rebuild its racing strip and thereafter, and during the fiscal year ended November 30, 1948, the Racing Commission gave its written and express permission to the taxpayer with respect thereto. Work on this project was begun and completed before the end of the fiscal year ended November 30, 1948, at a cost of $75,608.66. (R. 21.)

On November 24, 1948, the taxpayer forwarded its bills and invoices showing the performance of the work and furnishing of the materials including the cost thereof in connection with the rebuilding of the strip, together with payments thereof to the Maryland Racing Commission, and on November 29, 1948, the taxpayer received from the Commission, out of the funds deducted and deposited in the "Racing Fund" with the Commission by the taxpayer, a check for $75,608.66, as reimbursement for the expenditures made in rebuilding the racing strip. (R. 21-22.)

In its income tax return for the year ended No-

vember 30, 1948, the taxpayer included as income the sum of $75,608.66, as representing "withdrawal from Maryland Racing Commission Fund." (R. 17.) It later filed a claim for refund for $28,731.29, the tax attributable to this sum, alleging that (R. 17-18) the sum was erroneously included in its gross income. The claim was disallowed by the Commissioner. (R. 18.)

The taxpayer then brought this action to recover $28,731.29, plus interest, income taxes for the fiscal year ended November 30, 1948. (R. 65-66.) The District Court held that the Commissioner of Internal Revenue had erroneously included in the taxpayer's income for the year involved the sum of $75,608.66, and that consequently the taxpayer was entitled to recover the entire amount sued for in its complaint. (R. 5-6.) The decision of the District Court was reversed by the Court of Appeals. (R. 65-72.)

ARGUMENT

1. The sum of $75,608.66 paid to the taxpayer during November of 1948 by the Maryland Racing Commission out of the so-called "Racing Fund" was properly included in the taxpayer's income under the broad provisions of Section 22(a), Internal Revenue Code, Appendix, *infra*, p. 12. It was derived from pari-mutuel earnings of the taxpayer realized through the operation of its track. While it was required under state law to be set aside in a special fund subject to the control of the Racing Commission and there held in an account earmarked for the taxpayer's future use, it could be

released to the taxpayer for its use in making substantial alterations, additions, improvements, or repairs to its track, if reasonably needed, within three years from the date set aside. The sum did not and could not become part of the general funds of the State until after the expiration of the three year period. Flack, Annotated Code of Maryland (1947 Cum. Supp.), Article 78B, Appendix *infra*, pp. 12-15.

Since the sum was derived from labor and capital of the taxpayer, since it never unqualifiedly vested in the State and was released unconditionally and irrevocably to the taxpayer as a reimbursement for additions and improvements made to its track and since it was received by the taxpayer in the fiscal year ended November 30, 1948, without restriction and under a claim of right, it was clearly taxable income in that year.[2]

There is nothing in the provisions of the Annotated Code of Maryland as amended in 1951 and 1953, which supports the taxpayer's position here. The amendment of 1951 (Section 12, Article 78B (1951 Supp.) (Pet. 20-23)), does not substantially change the provisions of Section 12, Article 78B (1947 Cum. Supp.), Appendix, *infra*, pp. 13-15, which was in effect in the year involved, except that Section 12(a) of the amended statute refers to the amounts paid to the Maryland Racing Commission for the use of the State as a tax. It is provided, however, in Section 12(b) of the amended statute

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[2] *Eisner* v. *Macomber*, 252 U.S. 189; *North American Oil* v. *Burnet*, 286 U.S. 417; *United States* v. *Lewis*, 340 U.S. 590; *Mutual Tel. Co.* v. *United States*, 204 F. 2d 160 (C.A. 9th).

that the Commission is not required to remit any part of the "Racing Fund" to the Comptroller or Treasurer of the State unless and until the fund reverts to the General Treasury in the manner provided in Subsection (c) of the amended statute which in turn provides that the sum shall not revert to the State until elapse of the three year period.[3] Furthermore, the amendment of Section 12 by the addition of subsection (e) in 1953 (Pet. 23-24) had the effect of clarifying the law as it existed in 1948 as to the powers of the Maryland Racing Commission in making commitments and grants for expenditures previously made with respect to alterations, additions, changes and improvements on race tracks. It has little or no bearing on the issue here involved.

2. There is no conflict in decisions requiring resolution by this Court.

Despite the taxpayer's assertion (Pet. 13-14) that the instant decision is contrary to the principles enunciated by this Court in *Edwards* v. *Cuba*

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[3] The taxpayer's returns for the fiscal years 1944 to 1947, inclusive (Stip. Ex. D, E, F, G, R. 20) disclose that the taxpayer deducted the amounts paid to the Racing Commission in those years in determining its gross receipts and received tax benefits as a consequence. (R. 18-19.) Even if the sums had been collected by the State as a tax under the provisions of the 1951 amendment but had later been refunded to the taxpayer, they would have constituted income in the year received under the tax benefit rule. Section 22(b)(12), Internal Revenue Code, as added by Section 116 of the Revenue Act of 1942, c. 619, 56 Stat. 798; *Union Trust Co.* v. *Commissioner*, 111 F. 2d 60 (C.A. 7th), certiorari denied, 311 U.S. 658; *Electric Storage Battery Co.* v. *Rothensies*, 152 F. 2d 521 (C.A. 3d), affirmed on this point but reversed on other grounds, 329 U.S. 296; Section 12, Article 78B of the Annotated Code of Maryland, as amended (1951 Supp.) *supra*.

Railroad Company, 268 U.S. 628, it is apparent that the latter case is clearly distinguishable. In the *Cuba Railroad* case, it was decided that subsidy payments to that taxpayer by the Cuban Government out of its own treasury for the construction of a railroad were not made for services rendered or to be rendered and were not profits or gains from the use or operation of the railroad and consequently were not taxable income under the Sixteenth Amendment and statutes then in force defining income. Here, on the other hand, the funds in question were earned by the taxpayer, never became part of the general funds of the State, were held in a special account for the taxpayer's use, and finally did not in a true sense represent a governmental subsidy.[4]

Likewise, *Decatur Water Supply Co.* v. *Commissioner*, 88 F. 2d 341 (C.A. 7th), also cited by taxpayer as a contrary authority (Pet. 15-16), is clearly distinguishable. There the city created the taxpayer corporation to finance an addition to the City Water Works System. The court held that, under the peculiar facts involved, income from the operation of the water system was the income of the city rather than the taxpayer and that a percentage of the income which was to be paid to the taxpayer

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[4] Even if these funds had vested in the State and were later distributed to the taxpayer out of the State's general funds as a grant or subsidy to aid the taxpayer in the operation of its race track, the sums would undoubtedly be taxable income in the year received by the taxpayer. *Baboquivari Cattle Co.* v. *Commissioner*, 135 F. 2d 114 (C.A. 9th); *Lykes Bros. S. S. Co.* v. *Commissioner*, 126 F. 2d 725 (C.A. 5th), *Helvering* v. *Claiborne-Annapolis Ferry Co.*, 93 F. 2d 875 (C.A. 4th).

by the city under a contract, which was derived from net water rents, was received by the taxpayer as a conduit for its preferred stockholders because of provisions in the contract requiring that it be earmarked for the stockholders' use. The situation there was vastly different from that in the case at bar.

Although the taxpayer seems to contend to the contrary (Pet. 12-13), an opinion by the Attorney General for the State of Maryland on the taxability of the fund for state tax purposes would not of course be controlling in resolving the instant problem. However, there is nothing in the opinions of the State Attorney General which have been introduced in evidence which is contrary to the position we have taken here.[5]

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[5] Taxpayer's Exhibit A (R. 47) is a ruling by the State Attorney General in June, 1944, to the effect that race tracks did not derive income for state tax purposes through the initial collection of the amounts deposited with the Racing Commission for the reason that the sum was required to be held pending its disposition by action of the 1945 Maryland Legislature. The question here relates to its taxability in the year when the fund was later released, and not as to the year of its initial collection. On the other hand, the taxpayer's Exhibit B (R. 48), was a ruling by the State Attorney General of May 1950, on the question of whether this taxpayer was entitled to be reimbursed for expenditures made without approval of the Commission. While the Attorney General did not rule on the specific question here involved he did state (R. 50): "When, however, any part of the fund was released by the Commission to the track, it might be taxable income. If it reverted to the State, it never became subject to Federal Income Tax".

CONCLUSION

The decision below is correct. There is no conflict. The petition for certiorari should accordingly be denied.

Respectfully submitted,

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MAY, 1954.

APPENDIX

Internal Revenue Code:

SEC. 22 [as amended by Section 1, Public Salary Tax Act of 1939, c. 59, 53 Stat. 574]. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U. S. C. 22.)

Flack, Annotated Code of Maryland (1947 Cum. Supp.):

ARTICLE 78B.

1. There shall be a Maryland Racing Commission, and the same is hereby created and established, which said Maryland Racing Commission shall be vested with and possessed of the powers and duties in this Article specified and also the powers necessary or proper to enable it to carry out fully and effectually all the

purposes of this Article. The jurisdiction, supervision, powers and duties of the Maryland Racing Commission herein created and established shall extend under this Article to any and all person or persons, associations or corporations which shall hereafter hold or conduct any meeting within the State of Maryland whereat horse racing shall be permitted for any stake, purse or reward.

* * *

11. Said Racing Commission shall have full power to prescribe rules, regulations and conditions under which all horseraces shall be conducted within the State of Maryland. Said Commission may make rules governing, restricting or regulating betting on such races and may fix, regulate and condition the rate of charge of the licensee for admission, or for the performance of any service, or for the sale of any article on the premises of such licensee, and may regulate the size of the purse, stake or reward to be offered for the conduct of such races. Each licensee may deduct and retain for its own account one-half (½) of the breakage computed to the 10¢ and 6% of the mutuel pool, including any deduction required by the Commission as its agent pursuant to the provisions of Section 12 of this Article but exclusive of the 4% State tax imposed by Section 14 of this Article. * * *

12. For the calendar year 1947 and for each thereafter, each licensee shall, as the agent of the Racing Commission, deduct one-half of one per centum of the total amount of money wa-

gered on all races during each and every meeting and remit such deduction to the Commission. All such deductions shall be held in and comprise a fund to be known as the "Racing Fund", and shall be deposited by the Commission in one or more banks or trust companies in the State. The members of the Commission shall have no personal liability for loss to such Fund by reason of the failure or insolvency or other fault of any depository if they shall use ordinary care in the selection of the depository. The Commission shall require any depository to secure by collateral any deposit therein comprising a part or all of the Fund.

The amount of the Racing Fund on hand at any time, representing the deductions made by any particular licensee from the mutuel pool, previously collected by such licensee, as agent of the Commission, may, with the prior written and express permission of the Commission, upon such terms and conditions as it may prescribe, be expended by that particular licensee for any substantial alterations, additions, changes, improvements, or repairs to or upon the property owned or leased by such licensee, and by it used for the conduct of racing. In determining whether to permit the use of any of the Racing Fund, the Commission shall give due consideration to whether its expenditure in each instance will promote the safety, convenience and comfort of the racing public and of horse owners and, generally, whether it will tend towards the improvement of racing in the State. If the deductions, herein provided for, made by any licensee for any calendar year, as

agent of the Commission, shall neither have been spent nor binding commitments have been entered into for their expenditure, with the approval of the Commission, within three (3) years from the last day of the year of collection, the unspent portion of such year's deduction shall revert to the State as part of its general funds, and shall be paid over promptly by the Commission to the Comptroller. *Provided, however,* that due to the present war emergency, such deductions of any licensee for the calendar years 1944, 1945 and 1946 may be expended or binding commitments entered into for its expenditures at any time prior to December 31, 1950.

* * *

☆ U. S. GOVERNMENT PRINTING OFFICE: 1954 [illegible] 1957